5/26/81

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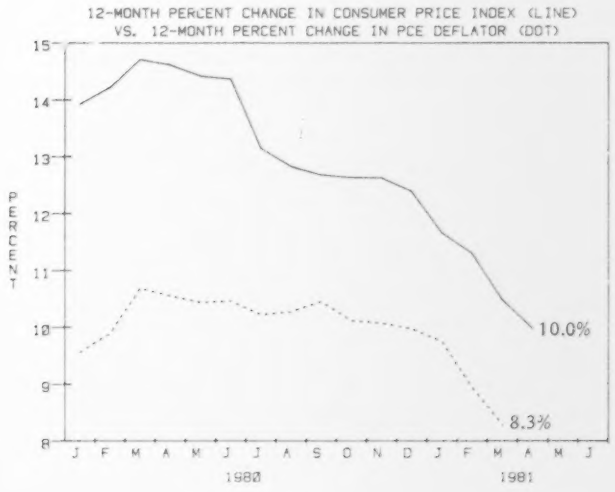
The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

FRIDAY, MAY 22, 1981 VOLUME XVIII, NUMBER 21

Inflation's Grip Is Loosening . . .

The upward spiral of the inflation rate appears to be over—even before the Administration could implement its planned inflation-fighting program of budget cuts. In the past six months, the widely-followed consumer price index (CPI) has climbed by an average annual rate of 9.6 per cent. When year-to-year comparisons are made, the improvement is even more striking (see chart). The 12-month increase in the CPI remains in double digits—but barely. What is more, there has been a progressive improvement over the past year. And the personal consumption expenditures (PCE) deflator has risen by only 8.3 per cent in the last 12 months.



The upward movement of prices of many components which previously contributed to the sharp rise has slackened, with some items even declining. Importantly, not only do such cyclical factors as food, energy and housing show improvement, but the underlying rate of inflation—the long-term relationship between wages and productivity—seems to be slowly descending.

Food prices, which rose sharply during the six-month period ending in December, 1980, have so far this year had a moderating influence on the CPI, mainly as a result of plentiful meat supplies. During the first quarter, meat prices declined by more than 25 per cent at an annual rate, in contrast to the 28 per cent annual rate of rise registered during the second half of last year. This has occurred because of excess production of beef and pork.

. . . But Food Prices May Rise Later . . .

However, because of high production costs, many farmers have been losing money. In an attempt to improve their profit margins, they have been cutting inventories and slaughtering more animals. In effect, this action has increased the supplies of meat in the marketplace, which, when coupled with declining beef consumption, has exerted significant downward pressures on prices. But there are signs that cattle inventories are near bottom and beef supplies will soon be curtailed. Similarly, pork supplies are tightening from their record year-ago levels. The March inventory of hogs and pigs showed that eight per cent fewer animals are available to be marketed this spring and summer than one year ago.

Declining red meat production will be partially offset by expanding poultry output. Department of Agriculture reports indicate an expansion in broiler output of three per cent during the second quarter of this year from year-earlier levels, and possibly a five per cent rise during the second half. Although increased substitution of poultry for beef and pork is likely to dampen price rises of red meat during the rest of this year, it may at the same time, put some upward pressure on the price of poultry.

The rise in energy costs has decelerated from its lofty pace posted early this year. The last round of OPEC-mandated price increases and the domestic deregulation of crude oil prices have resulted in an average four per cent monthly price increase during January and February of this year. However, the continued downward trend in U.S. consumption and consumer resistance to rising costs cut the price rise to two per cent in March and 0.1 per cent in April. Further pressure on prices of gasoline and other refined products prices is expected. U.S. stocks of crude oil were five per cent above year-ago high levels in April and remain substantially above normal. In light of the prevailing global oversupply

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of crude oil, several OPEC producers have been forced to lower their export quotes. Even many domestic oil companies have already slashed their wholesale prices in response to the existing excess stocks of oil.

Similarly, the housing component has tempered the rise in the CPI in recent months. The cost of home-ownership has registered smaller increases since the beginning of the year, mostly as a result of a dip in home prices, which partially offset the recent rise in mortgage interest costs. However, if interest rates ease from their current high levels, there may be an even more favorable impact on the overall rate of inflation from this source.

. . . While Wage Costs Decelerate

Most importantly, labor costs are showing substantial signs of abatement. Wage increases reached in collective bargaining settlements were smaller during the first quarter of 1981 than during 1980. Provisions for first-year wage increases were nine per cent, down from 9.5 per cent last year. Apparently, this has occurred not only because of expectations of lower inflation by employees, but also because of closer cooperation of labor with management, especially in such ailing industries as automobiles and steel where lower wage settlements or even pay cuts were needed to keep plants in operation (Financial Digest—March 13, 1981).

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 5/13/81	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies			
Owned Outright & RPs	126.911	– 2.402	– 1.919
Loans to Depository Inst.	1.734	– .737	+ .714
Float	4.202	+ 1.634	+ .977
Total Reserve Bank Credit	143.466	– 1.603	+ 4.830
Treasury Deposits with			
Federal Reserve Banks	3.299	– .876	+ .492
Currency Outside Banks	121.788	+ .673	+ 8.485
Member Bank Reserves:			
Required	39.928	– 1.161	– 3.525
Excess (Deficiency)	.005	– .391	– .035
Total Reserves Held	39.933	– 1.552	– 3.560
Net Borrowed Reserves	1.503	– .374	+ .571
Gov'ts held for Foreign Acct.			
by F.R. Banks (End-of-Week)	100.788	+ .363	+28.424

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M-1A	365.0	– 3.6‡	– 0.2‡
M-1B	428.8	+ 12.9‡	+ 11.5‡
M-2 (April '81)	1,733.8	+ 12.4	+ 11.8
L (February '81)	2,421.2	+ 13.3	+ 10.4

†Seasonally adjusted. * Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 5/22/81	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	16.70%	15.55%	14.40%
* Federal Agencies	17.20	16.55	16.45
* Project Notes—Taxfree (46% Taxable Equivalent)	11.85	13.89	13.33
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	17.75	16.50	

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	18.00%	Jun.	18.50%
15- 29 days	18.25	Jul.	18.30
30- 59 days	17.75	Aug.	18.20
60- 89 days	16.00	Sep.	17.90
90-119 days	15.38	Oct.	17.40
120-239 days	15.00	Nov.	16.90
240-270 days	12.00		

‡Industrial Paper—Prime			
30- 89 days	18.38%	†Federal Funds Effective Rate	19.40%
90-120 days	18.25		

‡Discount basis. * Subject to availability. r Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'81	$ 2,854	$ 2,731	$ 2,572
Gross National Product (1972 Dollars)*	1st Q'81	$ 1,516	$ 1,486	$ 1,502
Percent Change, Annual Rate	1st Q'81	8.4%	3.8%	3.1%
Change in Consumer Prices (all urban consumers)*	Apr '81n	4.8%	7.2%	10.8%
Change in Producer Prices*	Apr '81	9.6%	15.6%	9.6%
Civilian Employment (Thousands of Persons)†	Apr '81	98,976	98,412	97,225
Unemployment as % of Civilian Labor Force†	Apr '81	7.3%	7.3%	6.9%
Personal Income*	Apr '81n	$ 2,351	$ 2,338	$ 2,102
Leading Indicators Composite Index (1967=100)†	Mar '81	137.1	135.2	131.5
Industrial Production Index (1967=100)†	Apr '81	152.8	152.2	148.3
Net Change in Consumer Installment Credit†	Mar '81	$ 3.11	$ 2.00	$ 0.65
U.S. Merchandise Trade Balance†	Mar '81	$ 0.48	–$ 2.16	–$ 2.68
Plant and Equipment Expenditures*	2nd Q'81	$317.29(a)	$310.59(a)	$294.36
Private Housing Starts (Thousands of Units)*	Apr '81n	1,343	1,289	1,044
New Construction Expenditures*	Mar '81	$ 248.0	$ 254.0	$ 237.1
Total Business Inventories†	Mar '81	$ 471.8	$ 470.8	$ 443.0
Total Business Sales†	Mar '81	$ 345.9	$ 346.4	$ 310.3

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

While the rise in labor costs during the first three months of the year was still large because of a boost from increased Social Security payments, total compensation was partially offset by a 3.6 per cent rebound in productivity—the largest quarterly gain since late 1977. The improvement in productivity evidently continued through April, since manufacturing output expanded by 0.6 per cent compared with a 0.5 per cent rise in the total number of hours worked. And the operating rate rose to a very efficient 80.3 per cent of capacity. If productivity continues to pick up, the underlying rate of inflation will subside further.

To be sure, there are some upside risks in the inflation outlook. The weather could turn bad, oil production could suddenly drop or inflation psychology could be fueled by rising defense spending. However, the scales appear to be tipped in favor of further reductions in the rate of inflation—albeit at a slower pace.

A Slower Rate of Growth

Although the economy is not likely to repeat the first quarter's hefty 8.4 per cent annual rate of rise in the real GNP, it is not expected to decline, either. History shows that such a strong gain in the real GNP is not likely to be followed by a recession. Supporting this view is the latest survey by the

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (5/6/81)	116,131	+ 1,931	+20,578
New York City (5/6/81)	28,666	+ 358	+ 6,510
Commercial Paper (5/6/81)	139,607	+ 2,172	+13,304

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/6/81)	176,949	+ 2,424	+16,829
New York City (5/6/81)	52,120	+ 689	+ 5,326

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/6/81)	435,027	+ 4,502	+37,377
New York City (5/6/81)	103,630	+ 1,677	+14,656

Financial Markets

	Friday 5/22/81	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	16.64%	+ .05	+ 8.36
180-Day Bills†	15.50	+ .05	+ 6.78
Longest Bills†	14.36	+ .09	+ 5.37
Recent Issues:			
14 1/2s 4/30/83	15.56	+ .61	
13 3/8s 3/31/85	15.32	+ 1.30	
14 1/2s 5/15/91	14.94	+ .72	
13 7/8s 5/15/11	13.36	– .18	
Municipals:			
Bond Buyer—20 Bond Index* (5/21/81)	10.73%	– .10	+ 3.01
Blue List Total ($ Million)	$ 838	+ $ 78	+ $ 12
30-Day Visible Supply ($ Million)	$1,683	– $190	– $ 879
Total	$2,521	– $112	– $ 867
Corporates:			
Moody's Aa Composite (5/21/81)	14.91%	+ .02	+ 2.95
Money Mgr.—30-Day Supply ($ Million)	$5,373	– $494	+ $2,892
Stocks:			
Dow-Jones Averages:			
Industrials	971.72	– 14.23	+ 117.54
Transportation	426.53	+ .73	+ 161.19
Utilities	106.91	– 2.00	– 2.22
65 Stocks	379.87	– 3.70	+ 73.02
Standard and Poor's 500 Stocks	131.33	+ .63	+ 20.71
N.Y.S.E. Composite Index	76.26	– .28	+ 13.21
N.Y.S.E. Avg. Daily Vol. for Week (000's)	42,986	+ 1,142	+ 6,054

* 46% Taxable equivalent 19.87%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 5/22/81	Week Ago
Overnight	19.63%	18.50%
1 month	19.75	19.25
3 month	19.75	19.56
6 month	18.75	18.69
1 year	17.38	17.56
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	15.00%	14.75%
Long Term (7 to 15 yrs.)	14.75	14.38

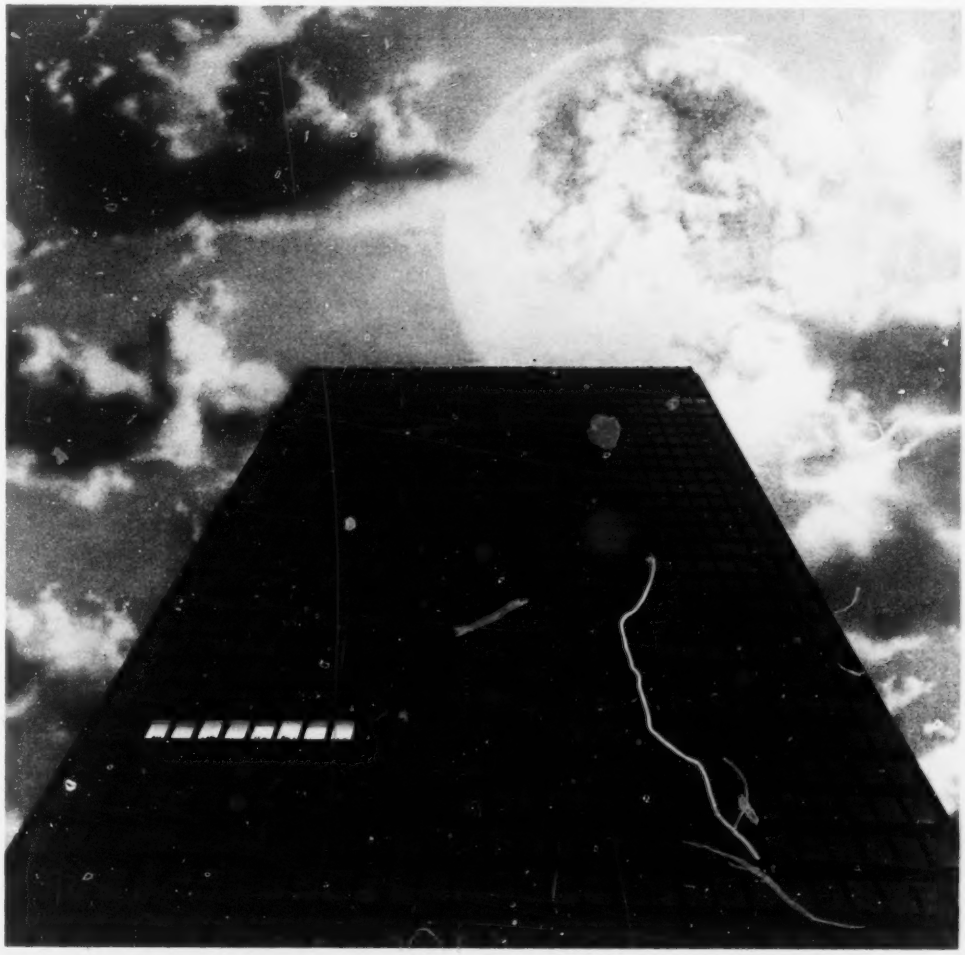
FOREIGN EXCHANGE SPOT RATES

New York Opening (5/22/81)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02644	37.82
Canada	.8324	1.2013
Denmark	.1373	7.2825
France	.1786	5.5980
Germany	.4307	2.3220
Italy	.0008719	1148.00
Japan	.004488	222.80
Mexico	.04146	24.12
Netherlands	.3885	2.5740
Switzerland	.4808	2.0800
U.K.	2.0580	.4859

National Association of Purchasing Management Inc., which found that the nation's purchasing managers are optimistic about a gradual improvement in the economy for the rest of the year.

Both production and new orders increased slightly in May after a substantial rise in April. Then, three times as many concerns increased production compared with the previous month than lowered production, while the number reporting higher orders was 6.7 per cent larger than those who received smaller orders. However, the 0.4 per cent decline in durable goods orders in April already shows that growth in the economy during the current quarter will be slower than that registered during the first. H

THE MOONLIGHTING PORTFOLIO.



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